

**THE OFFICE OF REGULATORY STAFF
DIRECT TESTIMONY AND EXHIBITS
OF**

GABY SMITH

March 14, 2013



DOCKET NO. 2012-199-S

**APPLICATION OF JACABB UTILITIES,
LLC FOR APPROVAL OF SEWER RATES,
TERMS AND CONDITIONS FOR THE
SHOALS AND ANCHOR POINT IN
ANDERSON COUNTY, SOUTH
CAROLINA**

DIRECT TESTIMONY OF GABY SMITH

FOR

THE OFFICE OF REGULATORY STAFF

DOCKET NO: 2012-199-S

**IN RE: APPLICATION OF JACABB UTILITIES, LLC FOR APPROVAL OF
SEWER RATES, TERMS AND CONDITIONS FOR THE SHOALS AND
ANCHOR POINT IN ANDERSON COUNTY, SOUTH CAROLINA**

**Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND
OCCUPATION.**

A. My name is Gaby Smith. My business address is 1401 Main Street, Suite 900, Columbia, South Carolina, 29201. I am employed by the South Carolina Office of Regulatory Staff (“ORS”) as an Auditor.

**Q. PLEASE STATE YOUR EDUCATIONAL BACKGROUND AND
EXPERIENCE.**

A. I received a Bachelor of Science Degree in Accounting from the University of South Carolina in May 2006. Prior to joining ORS, I held a variety of positions in finance, accounting, and auditing. I began my employment as an auditor with ORS in June 2009 and have participated in various audits of utility companies. I have previously testified before the Public Service Commission of South Carolina (“Commission”) on the Fuel Adjustment Clause.

1 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**
2 **PROCEEDING?**

3 **A.** The purpose of my testimony is to set forth my findings and
4 recommendations resulting from ORS's examination of the application of JACABB
5 Utilities, LLC ("JACABB" or "Company") in this docket, 2012-199-S. The
6 application was filed on November 28, 2012.

7 **Q. PLEASE DESCRIBE THE PROCEDURES USED TO PERFORM THE**
8 **EXAMINATION OF THE APPLICATION OF JACABB.**

9 **A.** ORS's examination of the Company's Application for Approval of Sewer
10 Rates, Terms and Conditions ("Application") consisted of three major steps. In
11 step one, ORS verified that the operating experience, reported by JACABB in its
12 application, was supported by JACABB's accounting books and records for the
13 twelve months ended December 31, 2011 ("test year"). In the second step, ORS
14 tested the underlying transactions in the books and records for the test year to
15 ensure that the transactions were adequately supported, had a stated business
16 purpose, were allowable for ratemaking purposes, and were properly recorded.
17 Lastly, ORS's examination consisted of adjusting, as necessary, the revenues,
18 expenditures, and capital investments to normalize the Company's operating
19 experience and operating margin, in accordance with generally accepted
20 regulatory principles and prior Commission orders.

21

22

1 **Q. PLEASE IDENTIFY THE EXHIBITS ATTACHED TO YOUR**
2 **TESTIMONY.**

3 **A.** I have attached the following exhibits to my testimony relating to the
4 Application:

- 5 • Audit Exhibit GS-1: Operating Experience & Operating Margin
- 6 • Audit Exhibit GS-2: Explanation of Accounting and Pro Forma Adjustments
- 7 • Audit Exhibit GS-3: Computation of Depreciation Expense Adjustment
- 8 • Audit Exhibit GS-4: Computation of Income Taxes

9 These exhibits were either prepared by me or were prepared under my direction
10 and supervision in compliance with recognized accounting and regulatory
11 procedures for wastewater utility rate cases. These exhibits show various aspects
12 of JACABB's operations and financial position.

13 **Q. PLEASE DESCRIBE THE FORMAT OF AUDIT EXHIBIT GS-1 AND**
14 **ELABORATE ON THE CALCULATIONS.**

15 **A.** Audit Exhibit GS-1 details JACABB's operating experience and operating
16 margin for wastewater operations for the test year. The exhibit's format is designed
17 to reflect JACABB's application per book amounts, ORS's proposed accounting
18 and pro forma adjustments necessary to normalize the results of JACABB's test
19 year operations, and to calculate the impact of the Company's proposed increase on
20 the normalized test year.

21 Column (1) details the application per book amounts reported by JACABB for the
22 test year. ORS verified total operating revenues of \$41,131, total operating
23 expenses of \$41,137, interest expense of \$2,088 and net loss for return of (\$2,094)

1 to the Company's books and records. The per book operating margin of (5.09%)
2 was calculated by dividing net loss for return by total operating revenues.

3 Column (2) details ORS's proposed accounting and pro forma adjustments
4 designed to normalize JACABB's application per books. An explanation of each
5 adjustment is contained in Audit Exhibit GS-2.

6 Column (3) details ORS's calculation of a normalized test year for JACABB by
7 adding columns (1) and (2). After the accounting and pro forma adjustments, net
8 loss for return of (\$14,849) was computed using total operating revenues of
9 \$42,561, less total operating expenses of \$54,638 and interest expenses of \$2,772.
10 An operating margin of (34.89%) was computed by dividing net loss for return by
11 total operating revenues.

12 Column (4) details the proposed increase, recalculated by ORS, and the calculation
13 of taxes associated with the proposed increase. An explanation of each adjustment
14 is contained in Audit Exhibit GS-2.

15 Column (5) details the effect of the Company's proposed rate increase by adding
16 columns (3) and (4). Net income for return of \$17,602 was computed using total
17 operating revenues of \$82,738, less total operating expenses of \$62,677, plus \$313
18 for customer growth less interest expenses of \$2,772. An operating margin of
19 21.27% was computed by dividing net income for return by total operating
20 revenues.

21 **Q. PLEASE EXPLAIN THE ADJUSTMENTS IN AUDIT EXHIBIT GS-2.**

22 **A.** For comparative purposes, ORS's and JACABB's proposed adjustments are
23 both presented in Audit Exhibit GS-2.

1 Adjustments 1-2 – The ORS Water and Wastewater Department proposes to
2 normalize wastewater revenues by \$1,289 for residential customers during the test
3 year and proposes an additional adjustment of \$141 for other sewer revenues. These
4 adjustments were provided by ORS witness Hannah Majewski.

5 Adjustments 3-9 – Operating Expense Adjustments:

6 ORS's operating expense adjustments total \$13,501:

7 Adjustment 3 – JACABB and ORS propose to increase contractual services
8 (management fees) by \$9,849 to account for the cost difference between
9 JACABB's per book amount of \$19,371 and their new management contract.

10 Adjustment 4 – ORS proposes to remove (\$1,485) from contractual services
11 (other) for the cost of replacing a fence and to capitalize this expense over a
12 period of eighteen years. In addition, ORS proposes to remove an expense of
13 (\$25) that was incorrectly booked to the Shoals service area. The total adjustment
14 was (\$1,510).

15 Adjustment 5 – ORS proposes to adjust for gross receipts and utility/commission
16 assessment taxes. Total pro forma revenues of \$42,561 were multiplied by the gross
17 receipts factor of .009356 for an assessment tax of \$398, less the per book amount
18 of \$132, resulting in an adjustment of \$266.

19 Adjustment 6 – JACABB and ORS propose to decrease miscellaneous expenses
20 by (\$875) for the cost of materials for the fence mentioned in adjustment 4. Along
21 with the (\$1,485) described in adjustment 4 above this totals (\$2,360) capitalized
22 for the fence, as shown on Audit Exhibit GS-3.

1 Adjustment 7– ORS proposes to annualize depreciation expense and adjust for
2 plant-in-service additions. The depreciation rates were provided by ORS’s Water
3 and Wastewater Department. The details of this adjustment are shown in Audit
4 Exhibit GS-3. ORS computed total depreciation expense of \$7,610 less the per
5 book amount of \$2,325, for a total adjustment of \$5,285.

6 Adjustment 8 – ORS proposes to add \$4,916 for rate case expenses. These
7 expenses mainly include fees for legal and accounting services. This amount
8 represents total expenses of \$24,582 amortized over a 5-year period.

9 Adjustment 9 – ORS proposes an adjustment of (\$4,430) to reflect state and federal
10 income taxes after accounting and pro forma adjustments. ORS used 5% for the
11 state rate and 15% for the graduated federal corporate rate for the calculation of
12 total income taxes. Details of this computation are shown in Audit Exhibit GS-4.

13 Adjustment 10 – ORS proposes to synchronize interest expense with JACABB’s
14 net capital investment in the Company. ORS computed allowable interest expense
15 of \$2,772, less the per book amount of \$2,088, for an adjustment of \$684.

16 Adjustments 11-12 – Based on the ORS Water and Wastewater Department’s
17 calculations, JACABB’s proposed rates would produce additional revenues of
18 \$39,996 for residential service, and \$181 for other revenues. This equates to
19 \$40,177 in additional revenue for Wastewater Operations. These adjustments were
20 provided by ORS witness Hannah Majewski.

21 Adjustment 13 – ORS proposes to adjust for gross receipts and utility/commission
22 taxes associated with the proposed increase. ORS used a factor of .009356 and the
23 proposed increase of \$40,177, for an adjustment of \$376.

1 Adjustments 14 – ORS proposes to adjust for state and federal income taxes
2 associated with JACABB's proposed rate increase. ORS proposes an income tax
3 adjustment of \$7,663. See Audit Exhibit GS-4 for the computation of this
4 adjustment.

5 Adjustment 15 – ORS proposes to adjust for customer growth after the Company's
6 proposed increase. The growth factor of 1.5625% was computed by the ORS
7 Water and Wastewater Department. This factor was applied to the net operating
8 income after the proposed increase, for a customer growth adjustment of \$313.

9 **Q. PLEASE DESCRIBE THE REMAINING AUDIT EXHIBITS.**

10 **A.** Audit Exhibit GS-3 shows the Depreciation Expense Adjustment. Audit
11 Exhibit GS-4 shows the Computation of Income Taxes.

12 **Q. DOES ORS AGREE WITH THE COMPANY'S REQUEST THAT THE**
13 **COMMISSION ALLOW THE PLANT'S PURCHASED ASSETS TO BE**
14 **ON THE DEPRECIATION SCHEDULE WITH A NEWLY DECLARED**
15 **SERVICE LIFE AS OF MARCH 2008?**

16 **A.** No. These purchased assets were already fully depreciated and it would
17 not be appropriate for the rate payers to pay again for the same assets.

18 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

19 **A.** Yes.

The Shoals and Anchor Point
(Component units of JACABB Utilities, LLC)
Docket No. 2012-199-S
Operating Experience & Operating Margin
Test Year Ending December 31, 2011
Sewer Operations

<u>Description</u>	(1) Application Per Books	(2) Accounting & Pro Forma Adjustments	(3) After Accounting & Pro Forma Adjustments	(4) Proposed Increase	(5) After Proposed Increase
<u>Operating Revenues:</u>					
Residential	\$ 41,131	\$ 1,289 (1)	\$ 42,420	\$ 39,996 (11)	\$ 82,416
Other	0	141 (2)	141	181 (12)	322
<u>Total Operating Revenues</u>	\$ 41,131	\$ 1,430	\$ 42,561	\$ 40,177	\$ 82,738
<u>Operating Expenses:</u>					
Purchased Power	\$ 5,950	\$ 0	\$ 5,950	\$ 0	\$ 5,950
Chemicals	1,617	0	1,617	0	1,617
Contractual Services: Professional	0	0	0	0	0
Contractual Services: Accounting	602	0	602	0	602
Contractual Services: Management Fees	19,371	9,849 (3)	29,220	0	29,220
Contractual Services: Testing	2,445	0	2,445	0	2,445
Contractual Services: Other	3,308	(1,510) (4)	1,798	0	1,798
Insurance	964	0	964	0	964
Regulatory Commission Expense	662	266 (5)	928	376 (13)	1,304
Miscellaneous	2,641	(875) (6)	1,766	0	1,766
Depreciation	2,325	5,285 (7)	7,610	0	7,610
Property Taxes	363	0	363	0	363
Rate Case	0	4,916 (8)	4,916	0	4,916
Provision (Benefit) for Income Taxes	889	(4,430) (9)	(3,541)	7,663 (14)	4,122
<u>Total Operating Expenses</u>	\$ 41,137	\$ 13,501	\$ 54,638	\$ 8,039	\$ 62,677
<u>Net Operating Income (Loss):</u>	(6)	(12,071)	(12,077)	32,138	20,061
Add: Customer Growth	0	0	0	313 (15)	313
Less: Interest Expense	2,088	684 (10)	2,772	0	2,772
<u>Net Income (Loss) for Return</u>	\$ (2,094)	\$ (12,755)	\$ (14,849)	\$ 32,451	\$ 17,602
<u>Operating Margin</u>	-5.09%		-34.89%		21.27%

The Shoals and Anchor Point
(Component units of JACABB Utilities, LLC)
Docket No. 2012-199-S
Explanation of Accounting and Pro Forma Adjustments
Test Year Ending December 31, 2011

ORS Adj.	JACABB Adj.	Description	ORS	JACABB
<u>Accounting and Pro forma Adjustments</u>				
<u>Operating Revenues</u>				
(1)		Residential To adjust residential revenue to reflect the pro forma number of customers at present rates.	\$ 1,289	\$ 0
(2)		Other To adjust other revenue to reflect the pro forma number including late fees and notification fees.	141	0
<u>Total Operating Revenues</u>			\$ 1,430	\$ 0
<u>Operating Expenses</u>				
(3)	(1)	Contractual Services: Management Fees To adjust the new management contract for increased costs.	\$ 9,849	\$ 9,849
(4)	(2)	Contractual Services: Other To remove the cost of replacing the fence and remove an expense that was incorrectly billed to the Shoals.	(1,510)	(880)
(5)		Regulatory Commission Expense To adjust for gross receipts and utility assessment fee.	266	0
(6)	(3)	Miscellaneous To remove the cost of materials for the fence.	(875)	(875)
(7)	(4)	Depreciation To adjust depreciation for capital improvements.	5,285	14,839
(8)	(7)	Rate Case Expenses To adjust for the 5-year amortization of rate case expenses.	4,916	5,000
(9)		Income Taxes, Utility Operating Income To adjust income taxes associated with ORS's accounting and pro forma adjustments. See Audit Exhibit GS-4.	(4,430)	0
<u>Total Operating Expenses</u>			\$ 13,501	\$ 27,933
(10)	(5)	<u>Interest Expense</u> To adjust for allowable interest expense.	\$ 684	\$ 3,472
<u>Applicant's Proposed Increase</u>				
<u>Operating Revenues</u>				
(11)	(8)	Residential To adjust residential sewer service revenues for ORS's recalculation of the Company's proposed increase.	\$ 39,996	\$ 41,580
(12)		Other To adjust other sewer service revenues for ORS's recalculation of the Company's proposed increase.	181	0
<u>Total Operating Revenues</u>			\$ 40,177	\$ 41,580
<u>Operating Expenses</u>				
(13)		Regulatory Commission Expense To adjust for gross receipts and utility assessment associated with the Company's proposed increase.	\$ 376	\$ 0
(14)	(6)	Income Taxes To adjust state and federal income taxes associated with the Company's proposed increase. See Audit Exhibit GS-4.	7,663	959
<u>Total Operating Expenses</u>			\$ 8,039	\$ 959
(15)		<u>Customer Growth</u> To adjust for projected growth.	\$ 313	\$ 0

The Shoals and Anchor Point
(Component units of JACABB Utilities, LLC)
Docket No. 2012-199-S
Computation of Depreciation Expense Adjustment
Test Year Ending December 31, 2011

Description	Plant in Service	Adjustments	Pro Forma Plant	Service Life	Depreciation Rate	Depreciation Expense
<u>Sewer - Gross Plant</u>						
Land and land rights	\$ 20,000	\$ 0	\$ 20,000	N/A	0.00%	\$ 0
Treatment and disposal equipment	22,500	(22,500)	0	15	6.67%	0
Blower- treatment & disposal equipment	6,587	0	6,587	12	8.33%	549
Treatment and disposal equipment	4,134	0	4,134	15	6.67%	276
Lift station pumps	0	15,071	15,071	12	8.33%	1,255
Utility pump	0	144	144	12	8.33%	12
Blower motor	0	586	586	12	8.33%	49
Step-down transformer	0	235	235	12	8.33%	20
Blower and pump	0	3,220	3,220	12	8.33%	268
Rebuild blower and control box	0	456	456	12	8.33%	38
Fence replacement	0	2,360	2,360	18	5.56%	131
Blower (far tank)	0	1,331	1,331	15	6.67%	89
Blower (rear tank)	0	1,331	1,331	15	6.67%	89
Blowers (electrical improvement)	0	6,791	6,791	15	6.67%	453
Electrical improvement	0	2,911	2,911	12	8.33%	242
Concrete slab for Blowers	0	1,612	1,612	27	3.70%	60
Shelter over blowers	0	8,030	8,030	20	5.00%	402
Re-pipe for new blower locations	0	4,054	4,054	15	6.67%	270
Install timer for backwash with solenoid valve	0	3,486	3,486	10	10.00%	349
Cleaning near and far tanks	0	1,980	1,980	8	12.50%	248
Painting tank/repairing holes	0	8,030	8,030	8	12.50%	1,004
Grating replacement	0	7,403	7,403	12	8.33%	617
Refurbish multi-media filter	0	6,534	6,534	10	10.00%	653
Install lift pump for clarifier effluent pump	0	509	509	12	8.33%	42
Shoals tank improvement	0	7,411	7,411	15	6.67%	494
TOTALS	\$ 53,221	\$ 60,985	\$ 114,206			\$ 7,610
Per Books						<u>2,325</u>
Deprecitation Expense Adjustment- (7)						<u><u>\$ 5,285</u></u>

**The Shoals and Anchor Point
(Component units of JACABB Utilities, LLC)
Docket No. 2012-199-S
Computation of Income Taxes
Test Year Ending December 31, 2011**

After Accounting & Pro Forma Adjustments

<u>Description</u>	
Operating Revenues	\$ 42,561
Operating Expenses	<u>58,179</u>
Net Operating Income before Taxes	(15,618)
Less: Annualized Interest Expense	<u>2,772</u>
Taxable Income - State	(18,390)
State Income Tax Rate	<u>5.00%</u>
State Income Taxes	\$ <u>(920)</u>
Taxable Income - Federal	(17,470)
Federal Income Tax Rate	<u>15.00%</u>
Federal Income Taxes	\$ <u>(2,621)</u>
Total State and Federal Income Taxes	(3,541)
Less: Income Taxes Per Book	<u>889</u>
Adjustment to Income Taxes - ORS Adjustment (9)	\$ <u>(4,430)</u>

After Applicant's Proposed Increase

<u>Description</u>	
Operating Revenues	\$ 82,738
Operating Expenses	<u>58,555</u>
Net Operating Income before Taxes	24,183
Less: Annualized Interest Expense	<u>2,772</u>
Taxable Income - State	21,411
State Income Tax Rate	<u>5.00%</u>
State Income Taxes	\$ <u>1,071</u>
Taxable Income - Federal	20,340
Federal Income Tax Rate	<u>15.00%</u>
Federal Income Taxes	\$ <u>3,051</u>
Total State and Federal Income Taxes	4,122
Less: Income Taxes As Adjusted	<u>(3,541)</u>
Adjustment to Income Taxes - ORS Adjustment (14)	\$ <u>7,663</u>